In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 476

BENJAMIN BRAUNSTEIN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 184–281) are reported at 36 T.C. 22. The opinion of the court of appeals (Pet. 1a–19a) is reported at 305 F. 2d 949.

JURISDICTION

The judgments of the court of appeals were entered on July 6, 1962. (Pet. 20a–22a.) The petition for a writ of certiorari was filed on October 1, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether Section 117(m) of the Internal Revenue Code of 1939, which provides that gain "from the

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sale or exchange * * * of stock of a collapsible corporation" is taxable as ordinary income rather than capital gain, is inapplicable in circumstances where the stockholders would have been entitled to capital-gains treatment had they conducted the enterprise in their individual capacities without utilizing a corporation.

2. Whether, during the course of a corporation's construction of a building, the stockholders contemplated (had "a view to") their later sale of the stock shortly after construction was completed, thus making the corporation a "collapsible" one as defined in Section 117(m).

STATUTE INVOLVED

Section 117(m) of the Internal Revenue Code of 1939 is printed in the Appendix, *infra*, pp. 7–9.

STATEMENT

The essential facts are summarized in the opinion of the court of appeals (Pet. 1a–3a) as follows:

The taxpayers, Benjamin Braunstein, Benjamin Neisloss, and Harry Neisloss, who had previously been active in constructing homes and apartment buildings, formed two corporations in 1948 for the purpose of building apartment houses in a development called Oakland Gardens in Bayside, New York, to be financed under Section 608 of the National Housing Act. Each of the taxpayers invested a total of $10 in each of the two corporations (R. 199–200, 215). The Federal Housing Administration guaranteed mortgage loans to the two corporations, which then built the proposed projects. Each corporation

had an excess of mortgage loan funds remaining after the costs of construction had been paid. In 1950, the year following completion of construction, the three taxpayers sold their stock in both corporations at a profit, and as part of the sale received distributions which included the excess mortgage funds from the two corporations. Each taxpayer had a gain of $313,854.17 on the distribution and the sale of his stock (R. 251). They claimed that their gains were taxable as long-term capital gains. The Tax Court, with one dissent, and the court of appeals held the gains taxable as ordinary income pursuant to Section 117(m) of the Internal Revenue Code of 1939 as gains realized from distributions from and the sale of stock in collapsible corporations.

ARGUMENT

Section 117(m) of the 1939 Code provides that gain from the sale of stock of a "collapsible corporation" is to be taxed as ordinary income rather than capital gain. A "collapsible corporation" is defined as one "formed or availed of principally for the manufacture, construction, or production of property * * * with a view to—(i) the sale or exchange of stock by its shareholders * * * prior to the realization by the corporation * * * of a substantial part of the net income to be derived from such property, and (ii) the realization by such shareholders of gain attributable to such property." Petitioners argue (1) that Section 117(m)'s prescription of ordinary-income treatment is inapplicable here even if the corporation was, as the courts below found, "collapsible"; and (2)

that the finding below that the stockholders had the requisite "view" to make the corporation "collapsible" was based on an erroneous standard. We acquiesce in the granting of certiorari on the first issue but oppose its grant on the second.

1. The court below rejected petitioners' argument that a transaction falling within the express terms of the "collapsible corporation" provision should nevertheless be exempted from that provision if the taxpayer could have obtained capital gains treatment for the transaction by carrying it out without the use of a corporation (Pet. 15a–19a). This decision is in conflict with that of the Court of Appeals for the Fifth Circuit in *United States* v. *Ivey*, 294 F. 2d 799, rehearing denied with opinion, 303 F. 2d 109.[1] We believe the court below was clearly correct and the Fifth Circuit in the *Ivey* case clearly wrong. However, in view of the direct conflict between the two decisions and of the continuing importance of the question in the administration of the revenue laws, we do not oppose the granting of the petition on this issue.

2. The second question is solely one of fact—namely, what was the state of mind of the stockholders during the construction of the buildings. If they then contemplated "selling out" shortly after construction was

[1] The court below relied in part upon Section 341(e) of the Code, enacted in 1958 (Pet. 19a), and noted that the Fifth Circuit in the *Ivey* case "did not discuss" this provision (Pet. 19a, n. 13). This circumstance does not suggest a lack of conflict, however, for the 1958 amendment was argued to the Fifth Circuit, and that court gave evidence of having considered the amendment by referring to its legislative history (294 F. 2d at 802).

completed, the corporation was a "collapsible" one as defined in Section 117(m). If at that time they did not contemplate an early sale, determining upon that course only after construction had been completed, the corporation may not have been collapsible. The Tax Court, affirmed by the court of appeals, found that the requisite "view" existed during the construction period. Whether that was a proper inference from the evidence is obviously not a question warranting review by this Court.

To avoid the impact of the clearly-erroneous rule, petitioners contend that the court below applied the wrong standards, substituting an "objective test" for the statute's subjective state-of-mind test (Pet. 11-18). The fact, however, is that, while the courts below examined the "objective" facts surrounding the transactions, they treated them not as ultimate facts but only as evidence from which to draw inferences about the stockholders' state of mind and the reasons for their actions. The court of appeals explained the relevance of its consideration of the surrounding facts by noting at the outset that the Tax Court was not bound to accept the unsupported testimony of the testifying stockholder, an interested party, about his state of mind (Pet. 5a), so that it was necessary to examine the other facts to see if the corroboration was so strong as to make the Tax Court's rejection of the testimony clearly erroneous. And having considered the "objective" facts and their implications in explaining the stockholders' actions, the court expressly reaffirmed the "subjective" nature of the

ultimate fact in issue and once again explained the limited relevance of the "objective" facts (Pet. 12a):

> * * * the question in issue is whether the taxpayers subjectively had a view to sell during construction. However, only by determining the objective facts and attempting to ascertain their effect on the taxpayers' minds can the court assess Benjamin Neisloss' self-serving testimony that the taxpayers had no view to sell until after construction had been completed.

The relevance of the objective facts so used cannot be doubted, and petitioners' ultimate complaint is simply over the validity of the inferences drawn—or refused to be drawn—from those facts, a question not meriting review here.

CONCLUSION

For the reasons stated, the petition for certiorari should be granted limited to Question 1 as stated in this brief (p. 2, *supra*).[2]

Respectfully submitted.

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[2] The Question Presented in the petition did not separate the two distinct issues (Pet. 2).

APPENDIX

Section 117(m) of the Internal Revenue Code of 1939, as amended by Section 212(a) of the Revenue Act of 1950, 64 Stat. 906, 26 U.S.C. (1952 ed.) 117, provides:

* * * * *

(m) *Collapsible Corporations.*—

(1) *Treatment of gain to shareholders.*—Gain from the sale or exchange (whether in liquidation or otherwise) of stock of a collapsible corporation, to the extent that it would be considered (but for the provisions of this subsection) as gain from the sale or exchange of a capital asset held for more than 6 months, shall, except as provided in paragraph (3), be considered as gain from the sale or exchange of property which is not a capital asset.

(2) *Definitions.*—

(A) For the purposes of this subsection, the term "collapsible corporation" means a corporation formed or availed of principally for the manufacture, construction, or production of property, or for the holding of stock in a corporation so formed or availed of, with a view to—

(i) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation manufacturing, constructing, or producing the property of a substantial part of the net income to be derived from such property, and

(ii) the realization by such shareholders of gain attributable to such property.

(B) For the purposes of subparagraph (A), a corporation shall be deemed to have manufactured, constructed, or produced the property, if—

(i) it engaged in the manufacture, construction, or production of such property to any extent.

(ii) it holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, or produced the property, or

(iii) it holds property having a basis determined, in whole or in part, by reference to the cost of property manufactured, constructed, or produced by the corporation.

(3) *Limitations on application of subsection.*—In the case of gain realized by a shareholder upon his stock in a collapsible corporation—

(A) this subsection shall not apply unless, at any time after the commencement of the manufacture, construction, or production of the property, such shareholder (i) owned (or was considered as owning) more than 10 per centum in value of the outstanding stock of the corporation, or (ii) owned stock which was considered as owned at such time by another shareholder who then owned (or was considered as owning) more than 10 per centum in value of the outstanding stock of the corporation;

(B) this subsection shall not apply to the gain recognized during a taxable

year unless more than 70 per centum of such gain is attributable to the property so manufactured, constructed, or produced; and

(C) this subsection shall not apply to gain realized after the expiration of three years following the completion of such manufacture, construction, or production.

For purposes of subparagraph (A), the ownership of stock shall be determined in accordance with the rules prescribed by paragraphs (1), (2), (3), (5), and (6) of section 503(a), except that, in addition to the persons prescribed by paragraph (2) of that section, the family of an individual shall include the spouses of that individual's brothers and sisters (whether by the whole or half blood) and the spouses of that individual's lineal descendants.

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